

Stripped De-risked Distributor

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“De-Risked Stripped” Distributor

- Distributor takes title for resale with minimal economic risk
 - Objective to minimize profit allocation to distributor without causing foreign company (manufacturer) to be engaged in a trade or business
- **Agency**
 - If agency and no treaty, income of manufacturer subject to tax (eg. U.S. force of attraction rule)
 - If goods are purchased, rather than manufactured by the exporter, full amount of income realized upon the sale would be sourced in the U.S.
 - If goods are manufactured by exporter outside the U.S., income would have mixed source

“De-Risked Stripped” Distributor - cont’d

- If treaty applies, dependent agent may cause permanent establishment (P.E.) for manufacturer and tax profits attributable to P.E. as if separate and distinct person
- Control (ability to sell goods without approval) and entrepreneurial risk (eg. risk of loss during transit, risk of bad debts, risk of contractual liability) relevant for determination of agency vs. purchase/resale
- *Challenge Publications, Inc. v. Commissioner*, T.C. Memo 1986-36 (1986), *aff’d* 845 F.2d 1541 (9th Cir. 1988): sale or return contract despite risk of loss and control
 - Court attached great significance to characterization of contract between the publisher and distributor and tax treatment accorded to transactions comported

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“De-Risked Stripped” Distributor - cont’d

- *Frank Handfield*: distributorship contract between Canadian manufacturer and U.S. distributor: agency in the form of a contract of consignment; taxpayer/manufacturer was engaged in a trade or business in the United States through a permanent establishment
 - U.S. Co. had exclusive rights to distribute; Taxpayer had control, liability

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“De-Risked Stripped” Distributor - cont’d

- **Transfer pricing**
 - Transfer of legal title not determinative of tax characterization of relationship

- **Tax ownership**
 - Generally requires that distributor have (1) some measure of risk of loss with respect to the goods and (2) responsibility for and control over subsequent resale
 - Risk of loss appears to include:
 - risk of liability for loss or damage in transit
 - risk of loss on resale
 - risk of non-payment by the customer
 - risk of contractual liability

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“De-Risked Stripped” Distributor - cont’d

- Control
 - U.S. distributor should be permitted to dispose of goods purchased from the foreign exporter based upon terms which are not dictated by foreign exporter, (subject to reservation of controls by the foreign exporter which are necessary to protect any of its intangible rights)

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